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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact: _____, ID No. _____

Telephone Number:

Refer Reply To:
CC:TEGE:EB:HW
PLR-113715-07

Date:
July 26, 2007

In Re:

LEGEND

Trust =

Agency =

State =

State Statute =

Dear :

This is in reply to a letter dated February 28, 2007 requesting a ruling on behalf of Taxpayer concerning the federal income tax treatment of the income generated through the operation of a trust of an agency of a state government. Agency is a joint powers agency created pursuant to State Statute. The members of Agency are community college districts and certain other public educational entities in State. Agency was established for the purpose of helping its members to fund post-employment benefits such as medical, dental, vision, life insurance, long-term care and

similar benefits offered by the participating employers to their employees as specified in each participating employer's policies and/or applicable collective bargaining agreements. Agency is governed by a board of directors. Agency proposes to amend its joint powers agreement to provide that in no case may an entity that is not a state, a political subdivision of state or an entity the income of which is excluded from gross income under section 115 of the Code become a voting member of Agency. Agency's primary sources of income are the start up and annual fees paid by the members to cover Agency's ongoing costs. The income of Agency is used to pay the ongoing costs associated with its operation and management. Such costs include general overhead expenses, legal services, investment advisory services, account management services, actuarial valuation services, reproduction and printing costs.

Agency adopted a trust agreement (Trust Agreement) creating Trust In order to accomplish its purpose of helping its members to manage and invest funds in their retiree health benefits plans. A member of Agency becomes a participating employer in Trust by entering into a participation agreement with Agency. Agency proposes to amend Trust Agreement to provide that in no case may an organization become a participating employer in Trust unless it is a state, a political subdivision of a state, or an entity the income of which is excluded from gross income under section 115 of the Code. Each participating employer has a separate account in Trust. The assets in the participating employer's separate account include all contributions received by the Trust on behalf of any participating employer, together with the income and earnings from such contributions. The assets are only available to pay post-employment health care and welfare benefits of the employees of the respective participating employer. Trust operates the investment programs under the direction of a trustee appointed by Agency. The trustee can be removed and replaced by Agency. The trustee invests a participating employer's contribution in accordance with the investment alternative selected by the employer from a list of investment alternatives designated by Agency in the participation agreement. The trustee also makes payments to health care providers pursuant to the participating employer's plan obligation.

Trust's assets are held in trust for the exclusive purpose of providing post-employment health care and welfare benefits to the employees of the participating employers and defraying the reasonable expenses associated with providing these benefits, and cannot be used for or diverted to any other purpose. No private interests participate in or benefit from the operation of Trust other than as providers of goods or services. Agency may amend or terminate Trust Agreement. Upon termination of Trust Agreement, the assets of each employer's separate account in Trust will be distributed in accordance with the participating employer's policies and/or applicable collective bargaining agreements. Any remaining assets shall be distributed to the participating employer. Agency proposes to amend the Trust Agreement to provide that upon the total termination of Trust none of the assets of Trust will be distributed to an entity that is not a state, a political subdivision of a state, or an entity the income of which is excluded from gross income under section 115 of the Internal Revenue Code.

Trust represents that the following statement will appear in bold type at the top of the first page of the post-employment health care plan and on the first page of every Participation Agreement:

"No guaranty that payments or reimbursements to employees, former employees or retirees will be tax-free. The Trust has obtained a ruling from the Internal Revenue Service concerning only the federal tax treatment of the Trust's income. That ruling may not be cited or relied upon by the Employer whatsoever as precedent concerning any matter relating to the Employer's health plan(s) (including post-retirement health plans). In particular, that ruling has no effect on whether contributions to the Employer's health plan(s) or payments from the Employer's health plans (including reimbursements of medical expenses) are excludable from the gross income of employees, former employees or retirees, under the Internal Revenue Code. The federal income tax consequences to employees, former employees and retirees depend on the terms and operation of the Employer's health plan(s)."

LAW AND ANALYSIS

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of a public utility or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign to properly conduct. In addition, pursuant to section 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under § 115 of the Code. In Rev. Rul. 90-74, private interests

neither materially participate in the organization nor benefit more than incidentally from the organization.

Trust provides health and welfare benefits to retired employees of the participating employers. Each of Trust's participating employers is required to be a state, a political subdivisions of a state or an entity the income of which is excluded from gross income under § 115(1) of the Code. Providing health and welfare benefits to current and former public employees constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Trust performs an essential governmental function within the meaning of § 115(1) of the Code.

The income of Trust accrues to its participating employers, all of whom are political subdivisions or entities the income of which is excluded from gross income under § 115(1) of the Code. No private interests participate in or benefit from the operation of Trust other than as providers of goods or services. The distribution of remaining funds in the separate accounts of the participating employers to their respective employees upon the termination of the Trust Agreement satisfies an obligation the participating employers have assumed with respect to providing health and welfare benefits to their employees. The benefit to the participating employees is incidental to the public benefit. See Rev. Rul. 90-74.

Based on the information and representations submitted by Trust, and provided the proposed amendments to the joint powers agency agreement and trust agreement described above are adopted, we hold that, as of the date the amendments are adopted, the income of Trust is derived from the exercise of an essential governmental function and will accrue to a state or a political subdivision thereof for purposes of § 115(1). Accordingly, Trust's income is excludable from gross income under § 115(1) of the Code.

No opinion is expressed on the classification of Trust as a trust or corporation for federal tax purposes. No opinion is expressed concerning the federal tax consequences of the Trust under any other provision of the Code other than those cited above. In particular, no representation is made regarding the federal tax consequences of contributions to or payments from an employer's health plan(s), including (but not limited to) whether contributions to the plan(s) are excludable from the gross income of employees, former employees or retirees under section 106 and whether payments from the plan(s) (including reimbursements of medical expenses) are excludable from the gross income of employees, former employees or retirees under sections 104 or 105.

This ruling is directed only to the Taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Powers of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Harry Beker, Chief
Health & Welfare Branch
Office of Division Counsel/Associate
Chief Counsel (Tax Exempt
& Government Entities)